

State of California  
BOARD OF EQUALIZATION

**SALES AND USE TAX REGULATIONS**

**Regulation 1525.3. MANUFACTURING EQUIPMENT—  
LEASES OF TANGIBLE PERSONAL PROPERTY.**

*Reference:* Sections 6244.5 and 6377, Revenue and Taxation Code.

**(a) GENERAL APPLICATION TO LEASES.** Leases of tangible personal property which are classified as “continuing sales” and “continuing purchases” of tangible personal property, in accordance with Regulation 1660, “Leases of Tangible Personal Property—In General,” may qualify for the partial exemption from tax for manufacturing equipment, under the conditions set forth in paragraph (i)(1) of Regulation 1525.2, “Manufacturing Equipment.” Lease transactions which qualify for the partial exemption are taxed at the rate specified in Regulation 1525.2, paragraph (a).

**(b) RECHARACTERIZATION.** With respect to transactions which the parties denominate as a “lease,” but which are recharacterized for sales and use tax purposes either as sales at their inception, pursuant to Regulation 1641, “Credit Sales and Repossessions,” paragraph (b), or as sales under a security agreement, Regulation 1660, “Leases of Tangible Personal Property—In General,” paragraph (a)(2), the transactions may qualify for the partial exemption, in accordance with Regulation 1525.2.

**(c) CONTINUATION OF PARTIAL EXEMPTION.** Where possession of tangible personal property is transferred to a qualified person as defined in paragraphs (c) and (d) of Regulation 1525.2 and pursuant to a lease agreement classified as a continuing sale and continuing purchase, lease receipts shall remain partially exempt for a period of six years from the date of the inception of the lease whether or not the lessee remains as a qualified person throughout the six year period. At the close of the six year period from the date of the inception of the lease, lease receipts are subject to tax without exemption.

**(d) LEASES OF TAX-PAID PROPERTY.** The partial exemption is not available to lessors who lease to qualified persons or to vendors to such lessors when the lessor elects to pay sales tax reimbursement at the time of acquisition of the property or pays use tax measured by the purchase price of the property.

**(e) MANUFACTURERS WHO LEASE QUALIFIED PROPERTY.** A lease of tangible personal property by the manufacturer of that property is ordinarily regarded as a “continuing sale” and “continuing purchase” in accordance with Regulation 1660, “Leases of Tangible Personal Property—In General.” Nevertheless, beginning January 1, 1997, a lessor of tangible personal property described in sections 17053.49 or 23649 of the Revenue and Taxation Code, who is the manufacturer of that property and who leases that property to a qualified person, as defined in section 17053.49 or 23649 of the Revenue and Taxation Code, in a form that is not substantially the same form as acquired, may, in lieu of reporting tax measured by the rentals payable, elect to pay tax measured by the cost price of that property where the election is made on or before the due date of the return for the period in which the property is first leased to the qualified person. The election shall be made by reporting use tax measured by the cost price of that property on the return for that period. The election shall not be revoked with respect to the property as to which it is made. The lease of that property for which an election is made to report and pay tax on the cost price of that property shall thereafter be excluded from the classification of a “continuing sale” and “continuing purchase.”

**Regulation 1525.3.** *(Continued)*

For purposes of this subdivision, “cost price” means the price at which similar property has been previously sold or offered for sale. If that property has not been previously sold or offered for sale, then the cost price shall be deemed to be the aggregate of the following:

- (1) Cost of materials.
- (2) Direct labor.
- (3) The pro rata share of all overhead costs attributable to the manufacture of the property.
- (4) Reasonable profit from the manufacturing operations which, in the absence of evidence to the contrary, shall be deemed to be 5 percent of the sum of the factors listed in subsections (1) to (3), inclusive.

*History:* Adopted January 10, 1996, effective April 4, 1996.

Amended November 4, 1997, effective December 4, 1997. Amended subdivision (c) and added new subdivision (e) to incorporate provisions of Chapter 954, Statutes of 1996.

*Regulations are issued by the State Board of Equalization to implement, interpret or make specific provisions of the California Sales and Use Tax Law and to aid in the administration and enforcement of that law. If you are in doubt about how the Sales and Use Tax Law applies to your specific activity or transaction, you should write the nearest State Board of Equalization office. Requests for advice regarding a specific activity or transaction should be in writing and should fully describe the facts and circumstances of the activity or transaction.*